



M2K Advisors



# Taxation of Trust – Part II

SUCCESSION PLANNING SERIES #26

# Cost of acquisition on settlement to trust



In a case where any capital asset became the property of the assessee pursuant to a transfer made to a revocable or an irrevocable trust, the cost of acquisition shall be deemed to be the cost for which the previous owner acquired the said property\* (i.e., cost to the settlor) [Section 49(1)(iii)(d)].



To this cost, the cost of improvement to the property, if incurred by the settlor, shall be added.



Further, the benefit of indexation shall be available from the year in which the previous owner (i.e., settlor) held the property and not from the year in which such property became capital asset of the assessee (Bombay High Court in the case of **CIT vs Manjula. J. Shah** (2013) 355 ITR 474 (Bom)).



*\*The cost incurred by the previous owner can be claimed as cost of acquisition by the person in whose hands the gains would be taxable and the same would depend upon the type of trust (i.e., specific or discretionary, etc.). Refer our upcoming series for detailed discussion on the same.*

# Analysis of Applicability of gift tax provisions (1/2)



- Section 56(2)(x) of the Income tax Act, 1961 ('the Act') provides that if any person receives any property\* from any person without any consideration or for inadequate consideration, then the difference between the fair market value of the property and the consideration paid (if any) shall be taxed as 'income' in the hands of the recipient under the head "Income from other sources".
- However, the provisions of Section 56(2)(x) shall not apply to any property received by a trust from an individual wherein the trust is established solely for the benefit\*\* of the individual.

\* *Property means immovable property being land or building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or bullion.*

\*\* *Relative, in the context of individuals, means – a) spouse of the individual b) brother or sister of the individual c) brother or sister of the spouse of the individual d) brother or sister of either of the parents of the individual e) any lineal ascendant or descendant of the individual f) any lineal ascendant or descendant of the spouse of the individual g) spouse of the person referred to in items (b) to (f)*

# Analysis of Applicability of gift tax provisions (2/2)



It can be inferred that the exception shall apply only when the property is received from an individual and not from any other person (i.e., HUF, firm, company, etc.,).



Further, it is not necessary that the transferor of the property should be the settlor since the exception shall even apply if the trust is created solely for the benefit of the relatives of the transferor. For example – Transfer of property by Mrs. B to a trust (established by Mr. B solely for the benefit of his son) shall not attract the provisions of Section 56(2)(x).



Generally, the term “relative” is tested from the recipient’s perspective while evaluating the exemption from gift tax in case of property received by a person from his relative. However, in the case of exemption for property received by private trusts, the term “relative” has to be tested from the donor’s perspective. Different results may emerge when viewed from the donor’s and recipient’s perspective and the same can be understood by way of the following examples:

- **Property contributed by nephew for the benefit of his uncle** – Section 56(2)(x) implications shall not apply since “uncle” is covered within the definition of relative from the nephew’s perspective (as per clause (d) of the definition of relative specified above).
- **Property contributed by uncle for the benefit of his nephew** – Section 56(2)(x) implications shall apply since “nephew” is not covered within the definition of relative when tested from uncle’s perspective.

# Section 56(2)(x) implications in the hands of the trustee (on settlement)



- At the time of settlement of trust, the property is transferred by the settlor / author to the trustee and such property is received by the trustee for the benefit of the beneficiaries. The trustee receives the said property under an obligation to hold / use the property for the benefit of the beneficiaries.
- Hence, the trustee is receiving the property under an obligation accepted by him for the benefit of the beneficiaries and such obligation can be treated as adequate consideration for receipt of the property thereby eliminating the scope of applicability of Section 56(2)(x) in the hands of the trustee.
- Further, the trustee would only be the legal owner of the property and not the beneficial owner since the economic value from the said property belongs to the beneficiary. In the context of **Gift tax**, the Bombay High Court in case of **CGT vs G. G. Morarji** [1965] (58 ITR 505) (Bom) held that “*The fundamental attribute of ownership of property is power or right of transfer and right to possess and enjoy property and/or its income. The trustee has no power to transfer trust property for his benefit, nor can he enjoy the trust property for his benefit. **He undoubtedly possesses the trust property, but the possession is for the benefit of others, the beneficiaries**”.*
- The above proposition, which is in the context of Gift tax Act, is equally relevant under Section 56(2)(x) of the Income tax Act from a trustee’s perspective.

# Succession Knowledge Series



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1. [An Introduction to Succession Planning](#)
2. [Types of Succession in India.](#)
3. [An Introduction to Hindu Succession Act](#)
4. [Rules of Intestate Succession Male - Part 1](#)
5. [Rules of Intestate Succession Male - Part 2](#)
6. [Illustrations on Intestate Succession for Male](#)
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